PLANNING LESSONS FROM LITIGATION

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Planning Lessons from Litigation

Walter Wm. Hofheinz[1]
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I. Introduction

The hope present when doing most legal planning is that there will be no resulting litigation. Often it is assumed that validly executed documents and an appropriate legal structure are sufficient concerns of the lawyer involved. As I have been in practice longer, and have recently become increasingly involved in litigation both as an advocate and as an expert, it has become apparent that limiting concerns to those narrow areas is not sufficient. It is also essential that the practitioner identify the possibility and likelihood of conflict arising from the transaction under consideration and take appropriate action where there is a context indicating a high probability of later conflict.

By being attentive to the possibility of litigation, planning can initially be implemented in such a way that should a dispute occur the person represented (or his or her intended beneficiaries) will be in the best position possible. Meticulous observation of formalities and creation of evidence negating bases upon which the transaction might be attacked are two concepts central to such implementation.

In addition, many clients, when left to their own devices for even a matter of months, not to speak of years, will potentially impair the best laid plans through inattention, inconsistent actions, lack of substantive knowledge, and inconsistent (or non-existent) record keeping. Realistic appraisal of the tolerance of the client for complexity and administrative overhead and their attendant continuing expense both in time and money at the inception of the plan provides one approach to mitigating this risk. Client education provides another.

This article provides contextual substantive background and addresses each of these problems and potential solutions in the context of selected legal and contextual frameworks.

II. Lesson One: If you can't prove it, it didn't happen.

Evidence is central to the resolution of most planning disputes. Frequently, there is no argument regarding the legal effect of actions if implementing documents are authentic and the actor had

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capacity at the time of the action, but a lack of evidence regarding authenticity and capacity allows a dispute. Capacity is particularly problematic, since most individuals view dispositive planning decisions as private decisions to be implemented with the minimal permissible disclosure, and most evidence of capacity is indirect. As a result, each possible witness may only have knowledge of a limited number of the pieces of the puzzle reflecting capacity, or lack of capacity.

The puzzle, when assembled with arduous effort and great expense in the litigation process, will always have pieces missing. With pieces missing, each side is able to construct a narrative supporting its position. Rarely does the outcome reflect the inferred "true" intent of the individual undertaking the planning, instead reflecting a complex balancing of legal and factual uncertainty and the economic realities attendant in the litigation process.

What do we need to prove?

A. Substantive context

1. Testamentary capacity.

a. Elements.

At the time the will is executed, the testator must be able to:

(1) understand the business in which he or she is engaged, specifically the making of the will,

(2) understand the effect of his or her act in making the will,

(3) understand the general nature and extent of his or her property, and

(4) know his or her next of kin and the natural objects of his or her bounty and the claims on them.

These elements must all coalesce: The testator must be able to hold them within his or her mind all at once and know how the various elements relate to each other. *Guthrie v. Suiter*, 934 S.W.2d 820, 829 (Tex.App.—Houston [1st Dist.] 1996, no writ).

b. Time determined.

Capacity to make a will is measured at ONE TIME ONLY – THE DATE AND TIME OF EXECUTION. *Guthrie,* 934 S.W.2d at 830. A will contestant who is challenging the will based on capacity will have to present evidence that, at that moment, the testator lacked the requisite capacity. *See Hamill v. Brashear*, 513 S.W.2d 602, 607 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.).

c. Circumstantial evidence.

Evidence of incompetency at other times may have probative value if it tends to show a persistent, consistent condition that existed at the time of execution. *Hamill,* 513 S.W.2d at 607. However, this type of evidence must amount to more than a suspicion or "surmise" of lack of

testamentary capacity, and must be "of a satisfactory and convincing character." *Hamill,* 513 S.W.2d at 608; *Horton v. Horton,* 965 S.W.2d 78, 85 (Tex. App.—Fort Worth 1998, no pet.).

The will at issue in *Horton* was executed, as is so often the case, by a terminally ill man. The testimony at trial indicated the testator was heavily medicated and that he had some mild hallucinations on occasion. The court held that the jury's verdict finding lack of testamentary capacity was improper. Evidence that the testator was ill, or that he consumed pain medication on the day of the will execution, is not tantamount to proof that he was incapable of knowing his worth, his family, or the effect of his actions. *Horton*, 965 S.W.2d at 86.

In contrast, in *Bracewell v. Bracewell*, 20 S.W.3d 14 (Tex. App.—Houston [14th Dist] 2000, no pet.) sufficient evidence was adduced to allow a valid inference as to the state of mind of the testator at the time of execution of the purported will. In *Bracewell*, several doctors testified that testatrix had been suffering from Parkinson's disease since 1984 and that when she signed her last will in 1989 she had been using and abusing various forms of tranquilizers for many years due to anxiety disorders, and later, her Parkinson's. One of her doctors specifically testified that on the date of the execution, there would have been no way testatrix would have been able to "keep up with all the complicated dealings of making out a will… ." *Bracewell,* 20 S.W.3d at 21.

2. Testamentary transfers

a. Qualifications to make a Will

In order to make a testamentary transfer, a testator must have a valid will. To write a will a testator must not only be of sound mind (discussed above), but also must be one of the following:

1) 18 years of age;

2) lawfully married; or

3) at the time the will is made, a member of the armed forces of the United States or of the auxiliaries thereof or of the maritime service.

b. Types of Wills

There are two types of wills in Texas: formal and holographic. (Provision for a third type of will, a nuncupative, or oral, will, was repealed in 2007. A nuncupative will made with the requisite formalities prior to September 1, 2007, is still governed by the law under which it was created.)

(1). Formal Wills

This is a will that complies with §59 of the Texas Probate Code, and is the type prepared by most lawyers. The requirements for a formal will are that it:

1) must be in writing;

2) must be signed by the testator in person or by another person for him by his direction and in his presence; AND

3) must be attested by two or more credible witnesses above the age of fourteen years, who must subscribe their names thereto in their own handwriting and in the presence of the testator.

To make a formal Will self-proving (no need for attesting witnesses to testify at a hearing), the testator and witnesses may sign a Self-Proving Affidavit at the time of execution, or at a later date. An example of a Self-Proving Affidavit can be found in §59 of the Probate Code.

(2). Holographic Wills

This is a will written entirely in the testator's handwriting. In this case, the Probate Code makes an exception to the witness requirement. There are only two requirements for a holographic will:

1) It must be a dispositive writing intended to be a Will, entirely in the testator's handwriting;

2) It must be signed by the testator.

To make a Holographic Will self-proving, the testator may attach or annex an affidavit stating that the instrument is his last will; that he met the legal capacity standard (age 18, etc); that he was of sound mind; and that he has not revoked the instrument. Tex. Prob. Code §60

3. General legal capacity to act (contract)

a. Standard.

A person has legal capacity to act and contract if he or she "[appreciates] the effect of what she [is] doing and [understands] the nature and consequences of her acts and the business she [is] transacting." *Mandell & Wright v. Thomas*, 441 S.W.2d 841, 845 (Tex. 1969); *Bach v. Hudson*, 596 S.W.2d 673, 675 (Tex. Civ. App.—Corpus Christi 1980, no writ).

b. Relevant facts.

(1). Mental state of actor.

Facts of the type which are important to show a person's mental capacity when signing a contract include:

1) a person's outward conduct manifesting an inward and causing condition;

2) pre-existing external circumstances tending to produce a special mental condition; and

3) prior or subsequent existence of a mental condition from which its existence at the time in question may be inferred

Rodriguez v. Garcia, 519 S.W.2d 908, 911 (Tex. Civ. App. Corpus Christi 1975, writ ref'd n.r.e.)

(2). Extrinsic factors.

(a). Inequity or foolishness of contract.

(b). Prior actions and conduct.

In *Bach*, Mr. Bach contracted to sell a piece of land, and then refused to fulfill the terms of the contract. Appellant sought to introduce evidence at trial that Mr. Bach had a previous contract set aside due to incapacity, and the land in the contract at issue was offered for approximately half its appraised value, without even considering a "shut-in" gas well. The court found that all of this was evidence the jury should have been able to hear at trial because it tended to show whether or not Mr. Bach had contractual capacity.

(c). Intoxication.

In order to rescind a contract based on intoxication, the person claiming they were intoxicated must show that their drunkenness arose to such a level that it, "dethroned reason, memory, and judgment, and impaired his mental faculties to an extent that would render him non compos mentis for the time being, especially where there is no pretense that any person connected with the transaction aided in or procured the drunkenness." *Wells v. Houston*, 57 S.W. 584, 594 (Tex. Civ. App. 1900).

This is a very high burden to meet. In *Christoph v. Sims*, 234 S.W.2d 901 (Tex. Civ. App—Dallas 1950, writ ref'd n.r.e.) Mr. Sims sought to annul a ceremonial marriage on the grounds that he was so intoxicated leading up to, during, and after the marriage that he did not know that a marriage had even occurred. However, while he may have become drunk on the trip to Mexico to get married, was drunk during the ceremony, and on the return trip to Texas, other evidence tended to show that he cohabitated with his wife before and after the ceremony. The level of intoxication and subsequent actions led the court to find that he was not so intoxicated that he could not have entered into a marriage contract.

c. Scope of admissible evidence.

A jury should be allowed to hear all testimony regarding the mental condition of the person whose capacity is questioned. *Carr v. Radkey*, 393 S.W.3d 806, 813 (Tex. 1965) *Bach*, 596 S.W.2d at 676. The only conditions imposed on admissibility are relevance and competence.

4. Effect of incapacity at time of action.

If the individual lacked capacity at the time of action, is the contract void? No. Contracts made by incapacitated people are voidable, not void. *Mo. Pac. Ry. Co. v. Brazil*, 10 S.W. 403, 406 (Tex. 1888). This is a major distinction from the effect of lack of testamentary capacity when signing a will. A voidable contract may be repudiated or annulled. *Brazil*, 10 S.W. at 406.

A voidable contract may also be subsequently ratified, and the right to annul will be lost. *Brazil*, 10 S.W. at 406; *Missouri Pac. R.R. Co. v. Lely Dev. Corp*., 86 S.W.3d 787, 792 (Tex. App.—Austin 2002, pet. dism'd). Ratification may be evidenced not only by some formal device, but also through behavior, such as acting under the terms of the contract. *Brazil*, 10 S.W. at 406. If

evidence tends to show that an incapacitated person after the time the contract was made was able to comprehend the nature and consequences of the business encompassed by the contract and acted inconsistently with repudiation of the contract, the failure is admissible to show ratification. *Brazil*, 10 S.W. at 406.

In *Brazil*, Mr. Brazil had signed a release of liability for an injury caused by a derailment on one of Appellant's trains. The evidence tended to show that Mr. Brazil had developed epilepsy, but also that his episodes were temporary, and that Mr. Brazil knew of the settlement after signing and continued to use the funds. Appellants were refused a jury instruction on ratification at trial. Upon appeal, the court found the refusal to be erroneous, holding that the jury might have found Mr. Brazil had ratified the contract had they been in instructed that subsequent ratification was possible. *Brazil*, 10 S.W. at 406.

4. No formal requirements to sign a contract

Unlike with a Will, there are no formal requirements to follow when one prepares and signs a contract or conveyance. A contract may be witnessed or verified by an acknowledgement taken before a notary, but neither of these precautions rise to the level of formality that accompanies a Will.

Because these safeguards found for Wills are not in place, contract signatures are more often points of contention. Not only could the validity of a contract be contested due to lack of capacity, but without a formal acknowledgement the authenticity of the signature on a legally effective document can be called into question.

5. Non-probate transfers.

This type of transfer is frequently used in an estate planning context because it potentially allows a more rapid transfer of assets such as bank accounts, insurance, and retirement plans, without the need for a court proceeding. Unfortunately, the informality of the process by which such designations are usually made and lack of required formalities, coupled with possibility of transfer of substantial assets, makes such designations more subject to dispute in the absence of precautionary measures.

There are two types of property subject to non-probate transfers. First are traditional survivorship estates under which property passes to the survivor of joint owners, such as a joint tenant with right of survivorship and community survivorship property. The second are assets subject to contractual transfer to some surviving person on the death of a party to the agreement, such as life insurance and multi-party bank accounts. The second category has broadened substantially over the years, so that designation of a payee on death is permissible although it would have previously been rendered ineffective under the requirements for a testamentary transfer.

a. Requirements

There are three parts to the section of the Texas Probate Code that deal with Nontestamentary Transfers: Multiple-Party Accounts, §§436-449; Provisions Relating to Effect of Death, §450; and Community Property with Right of Survivorship, §§451-462. Only parts 1 and 3 lay out

requirements for the creation of a nontestamentary transfer between two people, while part 2 deals with accounts that generally have beneficiary designations worked into the documentation (insurance, pension plans, retirement accounts, etc.).

(1). Multiple Party Accounts – Section 439(a)

This section governs the creation of joint accounts with rights of survivorship between people who are not married.

> Notwithstanding any other law, an agreement is sufficient to confer an absolute right of survivorship on parties to a joint account under this subsection if the agreement states in substantially the following form: "On the death of one party to a joint account, all sums in the account on the date of the death vest in and belong to the surviving party as his or her separate property and estate." A survivorship agreement will not be inferred from the mere fact that the account is a joint account.

Section 439A gives an example of what a single-party or multiple-party account form may look like. The form contains a choice between seven clauses. A person may (if provided by the financial institution), when opening an account, be able to select the provision relating to the type of account they intend to create. The choices are:

1) Single-party account without "P.O.D." designation;

2) Single-party account with "P.O.D." designation;

3) Multiple-party account without right of survivorship;

4) Multiple-party account with right of survivorship;

5) Multiple-party account with right of survivorship and P.O.D. designation;

6) Convenience account; and

7) Trust account.

(2). Provisions for payment at death – Section 450

This part, as mentioned above, deals with the provisions found in certain documents that commonly have beneficiary designations. Some of the more common documents listed in the statute include insurance policies, contracts of employment, deferred compensation arrangements, pension plans, accounts with financial institutions, and other written instruments effective as a contract, gift, or conveyance. If any of the following provisions are included in the documents named, they are deemed non-testamentary:

> 1) that money or other benefits theretofore due to, controlled, or owned by a decedent shall be paid after his death to a person designated by the decedent in either the instrument or a separate writing, including a will, executed at the same time as the instrument or subsequently;

2) that any money due or to become due under the instrument shall cease to be payable in event of the death of the promisee or the promissor before payment or demand; or

3) that any property which is the subject of the instrument shall pass to a person designated by the decedent in either the instrument or a separate writing, including a will, executed at the same time as the instrument or subsequently.

(3). Community Property with Right of Survivorship

This type of non-testamentary transfer is governed by §§451-462 of the Texas Probate Code. Section 451 says:

At any time, spouses may agree between themselves that all or part of their community property then existing or to be acquired, becomes the property of the surviving spouse on the death of a spouse.

Such an agreement must be in writing, signed by both spouses, and must include one of the following phrases:

1) "with the right of survivorship;"

2) "will become the property of the survivor;"

3) "will vest in and belong to the surviving spouse;"or

4) "shall pass to the surviving spouse

However, an agreement that otherwise meets the requirements of this section shall be effective without including any of those phrases. Tex. Prob. Code §452.

A party who claims the intent of the spouses was to create a right of survivorship bears the burden to prove the agreement complied with §452. *See* Tex. Prob. Code §456(a),(b)(3).

b. Statutory construction difficulties

One of the major of problems with this type of transfer is the standard forms used by various national insurance agencies, banks, and brokerage firms. Often they do not comply with the statutory requirements of Texas law, or the language does not exactly conform to that of the Probate Code.

A recent example of this is the *Holmes v. Beatty* case from the Texas Supreme Court. *Holmes v. Beatty*, 290 S.W.3d 852 (Tex. 2009). In that case, there was a standardized form from Dain Rauscher with instructions to strike out one paragraph or the other. One paragraph indicated that the parties wanted to create a survivorship account, the other a non-survivorship. *Beatty v. Holmes*, 233 S.W.3d 474 (Tex. App.—Houston [14th Dist.] 2007, aff'd in part and rev'd in part by *Holmes v. Beatty*, supra).

Both spouses signed the form. Neither paragraph was struck, but the phrase "JT TEN" was next to the signor's name. The appellate court ruled that even with the "JT TEN", the account did not meet the requisite formalities of §452. *Id.* at 481.

In reversing, in a radical departure from what most practitioners in the area would have said was the law, the Supreme Court held that §452 is less restrictive than §439(a) (the section used to create survivorship agreements between non-spouses), "presumably because agreements between spouses are less vulnerable to fraud." *Holmes*, 290 S.W.3d at 858. The Supreme Court found that the "JT TEN" was significant, and as trade usage, should have been used by the appellate court to find the requisite intent of the parties. *Id*. at 859.

It is important to note that the designations on forms providing for non-testamentary transfers may have drastic, unforeseen consequences for people who are subsequently divorced but do not change a designation, or who have blended families with children from previous marriages.

Particularly in light of the *Holmes* case, extreme care should be taken when reviewing asset information for planning clients.

b. Lack of formalities

There are typically few required formalities when signing the forms providing for a non-testamentary transfer. Some may have a spot for a witness; some may not. Even with a witness, signature authenticity and competency can be an issue.

B. Identifying scenarios in which precaution should be taken

Certain types of circumstances repeatedly demonstrate a high probability of a dispute arising. While each situation should be evaluated in the context of its own facts to determine the level of appropriate precautions to be implemented, the following circumstances almost always justify at least consideration of additional precautions. Frequently, the factors described are combined, enhancing further the possibility of dispute.

1. Blended families

Under the best of circumstances blended families are problematic. Even where relationships are long-term and cordial, the possibility of a dispute is heightened. Frequently, disagreements smoothed over by the presence of an individual surface following the individual's death. This is particularly true where relationships are established after children are adults. The probability of a dispute seems to be directly proportional to how close in age the surviving spouse or significant other is to the adult children.

2. Gifts to other than children and surviving spouse

If significant gifts are contemplated to someone other than children or surviving spouse, precautions should be taken. There seems to be an innate, and strong, predisposition in not only family members but juries to believe that any gift to someone other than a family member was

the result of lack of capacity or overreaching on the part of the beneficiary, even where strong evidence is present that such was not the case.

3. Gifts to or by attorneys in fact

As noted above, an attorney-in-fact stands in a fiduciary relationship to their principal, thus any transaction benefiting the attorney-in-fact is subject to question. In such cases particular care should be taken to document the basis for the transaction and the authorization of principal of the transaction.

4. Actions by individuals who appear to be impaired

Frequently disputes arise when action is taken by an individual who is very ill or taking continuing medication. In this context, appearances can justify creating appropriate safeguards for planning undertaken by the individual, even where no actual question regarding capacity exists.

5. Dispersed families with very different situations

As time passes, children find themselves in different circumstances. Some stay near home, some move far away. Some are economically successful, some are economically marginal. Some have continuing contact with parents on a routine basis, some speak to parents only infrequently. Values diverge. Frequently those who are far away believe that those who are nearby have received more benefits during their lifetime. In the context of lifetime planning, those with routine contact may develop very different perceptions of the status of a parent than those with infrequent contact, with resulting divergent opinions regarding the appropriate path in making healthcare and other lifetime planning decisions.

C. What to do

Frequently, there is very little evidence regarding authenticity or intention remaining after a particular planning action is taken unless specific attention is paid to creating such evidence. Even where a formal will is executed, there may be little direct evidence as to the capacity of the testator at the time of execution since pro-forma witnesses may have only limited knowledge of the testator, and the execution ceremony performed in a perfunctory manner. What can be done?

While many of the following suggestions may seem to be only common sense, I find they are often not observed. They are also most effective when combined. Some have no or minimal additional cost; all are extremely cost-effective when compared to the cost of litigation.

1. Implement procedural precautions

Careful attention to procedural precautions can go far in assuring that the transaction as contemplated by the individual undertaking it will be honored. It is at this stage of the process that it is possible for the person doing planning to communicate to persons acting as witnesses and third parties his or her understanding of the transaction. It is also at this stage of the process that a meritorious challenge can be made much more difficult.

a. Disclose action being taken

Perhaps the most effective thing one can do to minimize the chance of contest of an action is to fully disclose to all beneficiaries the action prior to and after the action has been taken. The more complete the disclosure the better. At a minimum, the client should communicate in writing to all beneficiaries the actions intended to be taken. If willing to do so, the client should provide copies of implementing documents to those affected for comment before signing, and after signing to inform them.

It is much easier for a slighted beneficiary to contest an action after the death of the client when the client is no longer present to speak for himself or herself. In addition, the silence of the beneficiary with knowledge of the action, and the failure of that beneficiary to seek a guardianship or otherwise set aside the action can be used to effectively impeach a later assertion of incapacity.

Where a dispute is likely to arise, disclosure should extend not simply to beneficiaries but also to those identified as possible witnesses with respect to capacity and intent.

b. Meticulously follow procedural requirements

Procedural requirements of whatever action is being taken should be meticulously followed. No shortcuts!

Where there are statutory requirements, as with wills, they should be fully and expressly observed. With only modest coaching, a testator can formally state that the document is his or her will, and that he is asking the witness to witness it as such. Witnesses can be instructed to intentionally observe the testator's signature of the will, and each other's signatures. The will signing can be uninterrupted, with the continuous physical presence and attention of the testator, witnesses, and notary.

Notarial acts should be formally taken; the notary should not sign the document without a formal oral acknowledgement, or oath or affirmation of the person taking the action.

c. Exclude interested parties not necessary to action

If it is not absolutely necessary to have a person benefitted either directly or indirectly by the action present when the action is taken, don't!

d. Use knowledgeable but disinterested witnesses

Where witnesses are required, a sensible, simple precaution is careful selection of the witnesses to be used. While in situations in which a dispute is not likely, use of office staff and other conveniently available witnesses does no harm, where factors indicate a dispute may arise the very limited knowledge of the witnesses about the person taking action may be problematic. There are two typical approaches to mitigating this problem depending on the perceived likelihood of the dispute.

Where risk factors exist, but the client believes the dispute is unlikely, a workable choice is to simply allow the witnesses time to converse with the testator to establish some contemporaneous knowledge of the testator's competence. More than casual conversation is preferable. The testator and witnesses can be coached regarding the elements of testamentary capacity, so that the discussion can include those items. At the conclusion of the execution process, as discussed below, a memo designed to refresh their recollection can be prepared and signed should use be necessary in the future.

An alternate approach is to use witnesses who are acquainted with the client, the client's circumstances, and the client's intentions. This has the obvious advantage that the witness is well acquainted with the client's situation and understanding of the actions that he or she is taking; it has the potential disadvantage that the witness may be perceived to be biased in some way with respect to the beneficiary bringing the contest.

e. Use notarial acknowledgement even where not required

Through the simple expedient of an acknowledgment before a notary, with the preservation of appropriate records by the notary, questions regarding the authenticity of the signature can be effectively eliminated. Even where not substantively required, such as on insurance beneficiary designations or other designations regarding non-probate property, an acknowledgement may be added for this purpose.

f. Take serial actions that affirm the action taken

Whether the client's action is testamentary or contractual, repeated reaffirmation of the action can make contest of the action much more difficult.

If a will is prepared and executed with safeguards, but no further action is taken, a contestant need only dispute the ability of the testator to act at the time the will was signed. If, however, subsequent to the execution of that will, multiple reaffirming codicils are prepared and executed with safeguards, a potential contestant is faced with the daunting task of showing that at each point at which a testamentary document was executed the testator lacked capacity.

Similarly, contractual actions can be reaffirmed. The client need not submit multiple beneficiary designations, for example, but might provide a written confirmation to his or her insurance agent declaring that it is his or her continuing intention that the beneficiary designation remain effective.

While the actual number of reaffirming actions is a matter of professional judgment, taking into account the expense and inconvenience to the client, I generally recommend not less than three reaffirming acts.

g. Identify and record possible additional witnesses

A great deal of effort, and resulting expense, at the inception of a litigation matter involves identifying those with relevant knowledge. Frequently the client is the only one in a position to have a comprehensive understanding of those who could substantiate his capacity and intent. For

the client while still alive, however, it may be a relatively trivial matter to provide a list of names with associated communication information. Where a dispute appears highly likely, the client may also wish to inform the witnesses that their names have been provided to counsel, confirm their willingness to act as a witness, and inform them that should a dispute arise they will be contacted.

h. Deposit originals with trusted third-parties

While the time is long past that counsel routinely retains originals of legally effective documents for clients, where a dispute is likely serious consideration should be given to depositing originals with a trusted third-party such as counsel or a corporate fiduciary acting as an escrow agent. Not only will such a course assure that the original document can be located, it can also effectively eliminate questions regarding authenticity.

2. Create and preserve evidence

In many cases, I find that documentary and contextual evidence is astoundingly lacking. Often no originals of governing documents can be found, copies of documents have markup that may or may not have been present on the original at the time of execution, there are limited exemplars of contemporaneous handwriting, the circumstances of execution are difficult to determine with precision, and there is little evidence of the intention or state of mind of the person undertaking the transaction at the time of the transaction.

a. Retain copies of documents (or duplicate originals of documents other than wills) provided to third parties

Increasingly, business document management systems rely upon scanning documents, then destruction (or archiving in inaccessible storage) of documents as they are received. Thus no original of a legally effective document may be available for use in evidence. Without an original document, the uncertainty attached to examination of disputed documents is greatly enhanced. Exacerbating this problem, the scanning implemented in many such document management systems is of relatively low resolution. Low-resolution scans can make determination of the authenticity of the signature much more difficult than where a duplicate original or high-quality photocopy is available.

Accordingly, it is very important to preserve the highest quality copy possible to increase the likelihood that a document examiner will be able to give unqualified or close to unqualified opinion regarding the authenticity of the signature or other handwriting samples. For documents other than wills, a duplicate original can be executed and clearly labeled as such. For wills, a high-resolution scan can provide an excellent copy.

b. Create and preserve original exemplars of contemporaneous signatures

Where it is not possible to retain an extra original of the document (such as where Will is being executed) additional exemplars of the individual's handwriting at the time the legally effective document was prepared can be preserved. Frequently, where there is physical impairment, even though the individual has full mental capacity to act, a signature can vary greatly from time to

time, and from the typical historical signature. Accordingly, it is important that such exemplars be close in time to the actual execution of the document, and their provenance be documented either through witness statements or acknowledgment.

c. Create correlating statements

While not admissible in evidence, a correlating statement signed by persons participating in the execution process can provide an invaluable reminder at a later date when direct recollection has faded. Included in the statement can be checklist of required actions observed by the witness or other participant in the process.

III. Lesson Two: Murphy was right! If anything can go wrong, it will.

A. Substantive context

1. Business entities

Business transactions provide a convenient context for examination of certain types of recurring problems that become evident in the course of litigation. These problems are exacerbated by the continuing trend to minimize formalities associated with the creation and operation of statutory entities.

a. Types of entities.

The Texas Secretary of State's website lists the six most common types of business structures in Texas. They are:

(1). Sole Proprietorship

This is the simplest form of business where a single individual engages in business activity without the need for formal organization.

(2). General Partnership

Created when two or more people associate to carry on business for profit. These are usually operated by the terms of a partnership agreement, but there is no requirement that that agreement be in writing or filed with any government agency.

(3). Corporation

An entity that allows for centralized management, perpetual duration, and easy transferability of ownership interests. Owners are shareholders, and the business of a corporation is carried out by directors. There are two types of corporations: C and S. A "C" Corporation is the default corporation and is a separately taxable entity. An "S" Corporation is a pass through tax entity. To elect to be an "S" Corporation, one has to file a form with the IRS.

(4). Limited Liability Company

This is neither a partnership nor a corporation, but has the powers of both. The owners are called "members" who generally have no liability for obligations of the LLC.

(5). Limited Partnership

An entity formed by two or more persons that has one or more general partners and one or more limited partners. The partnership agreement is not filed with the Secretary of State, but a certificate of formation is required.

(6). Limited Liability Partnership

A general or limited partnership may elect to limit the liability of its general partners by electing this type of entity. Partners are not personally liable for the negligent acts of other partners or partnership employees (except in very limited circumstances), and are not personally liable for the contractual obligations of the LLP.

Only the last four have formal formation requirements, although if a sole proprietorship or general partnership operate under an assumed name, they should file an assumed name certificate (DBA) in the office of the county clerk in the county where the business premise is maintained. It is also always a good idea for people operating a sole proprietorship or a general partnership to keep the same kind of detailed records that are required for the other entities.

b. Requirements to form and maintain an entity are generally the same for all entities.

There are three basic steps to creating an entity in Texas:

(1). Person

There must be an organizer or organizers (can be a natural person 18 years or older, or another entity) whose job it is to execute the certificate and send it to the Secretary of State. Tex. Bus. Org. Code §3.004.

(2). Paper

Texas Business Organizations Code §3.005 says:

(a)The certificate of formation must state:

(1) the name of the filing entity being formed;

(2) the type of filing entity being formed;

(3) for filing entities other than limited partnerships, the purpose or purposes for which the filing entity is formed, which may be stated to be or include any lawful purpose for that type of entity;

(4) for filing entities other than limited partnerships, the period of duration, if the entity is not formed to exist perpetually and is intended to have a specific period of duration;

(5) the street address of the initial registered office of the filing entity and the name of the initial registered agent of the filing entity at the office;

(6) the name and address of each:

(A) organizer for the filing entity, unless the entity is formed under a plan of conversion or merger;

(B) general partner, if the filing entity is a limited partnership; or

(C) trust manager, if the filing entity is a real estate investment trust;

(7) if the filing entity is formed under a plan of conversion or merger, a statement to that effect and, if formed under a plan of conversion, the name, address, date of formation, prior form of organization, and jurisdiction of formation of the converting entity; and

(8) any other information required by this code to be included in the certificate of formation for the filing entity.

(b) The certificate of formation may contain other provisions not inconsistent with law relating to the organization, ownership, governance, business, or affairs of the filing entity.

(c) Except as provided by Section 3.004, Chapter 4 governs the signing and filing of a certificate of formation for a domestic entity.

(3). Act

The organizers or organizer must sign the certificate, deliver it to the Secretary of State, and pay the required fee. Both facsimile and electronic submissions are accepted.

c. Recordkeeping required of all entities–TBOC § 3.151.

This section of the Business Organization Code provides:

(a) Each filing entity shall keep:

(1) books and records of accounts;

(2) minutes of the proceedings of the owners or members or governing authority of the filing entity and committees of the owners or members or governing authority of the filing entity;

(3) at its registered office or principal place of business, or at the office of its transfer agent or registrar, a current record of the name and mailing address of each owner or member of the filing entity; and

(4) other books and records as required by the title of this code governing the entity.

(b) The books, records, minutes, and ownership or membership records of any filing entity, including those described in Subsection (a)(4), may be in written paper form or another form capable of being converted into written paper form within a reasonable time.

(c) The records required by Subsection (a)(2) need not be maintained by a limited partnership or a limited liability company except to the extent required by its governing documents.

It is essential that proper records are maintained. Governing members are allowed to inspect these records for any purpose reasonably related to that person's service. TBOC § 3.152. Owners and members also have a right to examine the records. TBOC §3.153

d. Additional requirements for formation and operation of particular types of entities.

Though the basic formation and operation requirements are the same for each type of entity there are a few notable differences.

(1). Corporations.

After formation, an organizational meeting should be held to adopt bylaws, elect officers, and transact other company business. TBOC §21.059. A corporation must hold an annual shareholders' meeting. TBOC §21.351

(2). Limited Liability Companies

After formation an LLC may create a "company agreement" which will govern the relations of its members, managers and officers. TBOC §101.052. This is comparable to the bylaws of a corporation. Texas law presumes that the management of an LLC will be vested in one or more managers, but this may be negated in the certificate of formation or company agreement. TBOC §§101.251, .252. The meeting requirements for doing business are outlined in Chapter 101, Subchapter H of the TBOC. While there are no requirements to meet within any specific time frame, if a meeting is to be held, and members do not constitute the governing authority of the LLC, then notice must be sent of the meeting not earlier than 60 days and no less than 10 days before the meeting is to take place.

LLCs must also keep and maintain supplemental records for inspection, in addition to those listed in §3.151. They must keep a list of who owns what percentage of the LLC and the names of each class or group of membership; a copy of all tax returns from the last six years; a copy of the certificate of formation; a copy of the company agreement if it is in writing; executed copies of any powers of attorney; and a copy of any document establishing a class or group of members. If the company agreement is not in writing, they must keep a written statement of the cash contributions of each member, dates of additional contributions, any event which will require a member to make an additional contribution, any event that requires the winding up of the company, and the date each member became a member. TBOC §101.501.

(3). Limited Partnerships.

Limited Partnerships are covered by Chapter 153 of the TBOC. Texas has also adopted the Revised Uniform Limited Partnership Act of 1976 (RULPA), as well as the amendments proposed in 1985. These two sources govern limited partnerships. A certificate must still be

filed in accordance with the TBOC. The liability of a limited partner is generally limited to the capital he contributed to the company. Records must be maintained at an office in the organizing state. There must be a record that contains:

1) The amount and a description of each partner's contribution,

2) Times or events that trigger additional contributions from the partners,

3) A description of the events that require winding up of the partnership, and

4) The date on which each partner became a partner. TBOC §153.551

Limited Partnership may also be required to file a periodic report with the secretary of state not more than every four years. TBOC §153.301

(4).Limited Liability Partnerships.

An LLP is exactly like a general partnership, except that a partner is not liable for any obligations of the LLP. To form an LLP, one must register with the Secretary of State (certificate of formation), pay a $200 fee per partner and file an annual renewal application, have LLP in the title, and liability insurance policy, or segregate $100,000.

2. Characteristics of equity interests

Each type of entity has an equity interest with particular default characteristics regarding management, distributions, and rights and liabilities of participants. Of particular note in our current context is the ability of the party creating the entity and governing documents to structure management in such a way that those investing in the entity have no or minimal management rights, assurances of distributions, and ability to recover amounts invested. Clients frequently do not understand that this is the case, believing instead that all entities are equivalent and that compliance with minimal formation formalities are adequate to create a viable operating entity, and that their interests are automatically protected.

B. Signs and portents that precaution should be taken

As with dispositive planning, certain recurring factors suggest extra precautions be taken in the course of a transaction.

1. Suggested need for speed in completing transaction

Infrequently, perceived urgency in completing a transaction is appropriate. In general, however, the suggestion of urgency by any party to a transaction should raise a red flag, and cause a very close examination of the details of the transaction.

2. Deals based on friendship or "trust me"

Any transaction based on friendship or the assertion that one party can "trust" the other party about any aspect of the transaction are inherently suspect. Author Robert Heinlein once wrote

that when somebody says "trust me" you should make them pay cash, because cash is always truthful. The same principle applies to every aspect of the business transaction.

3. Lack of verifiable financial and other material contextual information

If all information relied upon by the client in entering into the transaction is not fully verifiable, extreme caution should be exercised. If a dispute does arise, it is unlikely that evidence related to these matters will become more available instead of less. In addition, the failure to make inquiry sufficient to constitute "due diligence" is often asserted as a defense to a claim that misrepresentations were made as an inducement to enter into the transaction.

4. "Standard" or incomplete documentation

This problem has become more prevalent since enactment of the business organization code reduced the formalities associated with the creation of entities. There has also been a reduction in the perceived need for legal representation in the formation process. Frequently, an entity is created by filing a certificate of formation, but no governing document such as bylaws or a company (member) agreement is prepared. In some cases, a party undertaking the transaction has participated in prior similar transactions and simply desires to reuse documentation prepared in the course of that transaction without appropriate modification.

C. What to do

1. Exercise due diligence regarding material facts

All material facts regarding the transaction should be verified.

Where, for example, the client contemplates purchasing a business interest for an ongoing business, actual, signed tax returns should be reviewed for the three years preceding the transaction and should be correlated with bank statements. If existing business relationships are a material factor to the transaction, such relationship should be independently verified. The existence of claimed physical assets should be verified.

Surprises are best discovered before money and interests change hands.

2. Match terms of transactions to intent of parties

In most initial interviews potential litigation clients tell a story that discloses their understanding of the transactions entered into. Unfortunately, all too often that story is not consistent with the documents used to implement the transactions.

Perhaps the two most important things that can be done to avoid litigation in this area is to assure that there is a meeting of the minds regarding the expected outcome of the intended transaction, and that the implementing documents correctly reflect the intent of the parties to accomplish that outcome. While nearly all clients are averse to legal fees, there simply are no standard terms and conditions that meet the needs of all transactions.

3. Create paper trail, avoid electronic fund transfers

There simply is no substitute for complete, paper records as an evidentiary trail documenting transactions. All aspects of the transaction should be reduced to writing, and the original documents retained. If electronic retention is desired as well, that is fine, but electronic retention should not be substituted for the documents themselves.

Fund transfers should be clearly documented. Almost all clients have become comfortable with online transactions, including bill payment, bank records, and fund transfers. While such financial activities are convenient, they provide only limited archival information regarding the transaction. It is preferable to use paper checks, since even if the original is not returned bank records will reflect payment information. If electronic transactions are unavoidable, they should be fully, contemporaneously documented through written, signed instructions and receipts.

IV. Lesson Three: Confusion is the source of much unhappiness (and litigation)!

We examine this rule in the context of fiduciary duties. An attorney in fact or trustee cannot simply act as they might as an individual, or even consistently with a course of conduct established while the principal was competent in the case of a durable power of attorney.

A. Substantive context

1. Principal and Agent

Since the creation of the durable power of attorney, lifetime planning is frequently implemented through such a tool. Frequently, the agent/attorney-in-fact does not understand the scope of responsibility being undertaken and duties imposed. This may be particularly problematic since the typical power of attorney does not spell out the duties of the agent, as a trust agreement does for a trustee, but instead only grants powers.

While all agents stand in a fiduciary relationship to their principal, a durable power of attorney is purely statutory, and the relationship and obligation of the agent under a durable power to account to their principal was in 2001 codified in §489B of the Probate Code.

The relevant provisions found for our purposes in §489B include the following:

> (c) The attorney in fact or agent shall maintain records of each action taken or decision made by the attorney in fact or agent.
>
> (d) The principal may demand an accounting by the attorney in fact or agent. Unless otherwise directed by the principal, the accounting shall include:
>
> > (1) the property belonging to the principal that has come to the attorney in fact's or agent's knowledge or into the attorney in fact's or agent's possession;
> >
> > (2) all actions taken or decisions made by the attorney in fact or agent;
> >
> > (3) a complete account of receipts, disbursements, and other actions of the attorney in fact or agent, including their source and nature, with receipts of principal and income shown separately;

(4) a listing of all property over which the attorney in fact or agent has exercised control, with an adequate description of each asset and its current value if known to the attorney in fact or agent;

(5) the cash balance on hand and the name and location of the depository where the balance is kept;

(6) all known liabilities; and

(7) such other information and facts known to the attorney in fact or agent as may be necessary to a full and definite understanding of the exact condition of the property belonging to the principal.

(e) Unless directed otherwise by the principal, the attorney in fact or agent shall also provide to the principal all documentation regarding the principal's property.

2. Trustees

a. The terms of the trust agreement govern.

The Texas Trust Code §111.0035 provides that in a conflict between the trust agreement and the Trust Code, the agreement will govern. There are two important exceptions to this general rule that relate to trustee duties:

1) To the extent a trust has an exculpatory provision, it may not relieve the trustee of liability for a breach of trust committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary. Tex. Prop. Code §§111.0035 and 114.007.

2) A trust may not relieve the trustee of his duty to account to a beneficiary.

b. Best evidence is parties' intent.

When provisions are ambiguous, a court will look beyond the four corners of the document. *Johec v. Clayburne*, 863 S.W.2d 516, 519 (Tex. App.—Austin 1993, no writ). The parties' actions and conduct after the trust was executed is the best evidence to determine how a document should be interpreted. *Id*. The Texas Supreme Court has said, "that great, if not controlling, weight should be given by the court to the interpretation placed upon a contract of uncertain meaning by the parties themselves." *Harris v. Rowe*, 593 S.W.2d 303, 306 (Tex. 1979)

c. Trust Code, Chapter 113 governs a Trustee's duties unless explicit in trust document.

In the absence of specific provisions in a particular trust, a Trustee's actions are governed by Texas Trust Code, Chapter 113, Subchapters A and B, and common law. Subchapter A describes what a Trustee may do concerning the trust property (buy, sell, rent, abandon, etc). Subchapter B concerns a Trustee's duties. A Trustee is a fiduciary with respect to the beneficiaries. Generally, a Trustee owes the duty of loyalty and utmost good faith, duty of candor, duty to refrain from self-dealing, duty to act with integrity of the strictest kind, and duty of fair, honest dealing. The interest of the beneficiary must come first.

d. Assure that Trustee understands duties and constraints.

To administer a trust, it is essential that the Trustee knows what the document says, know his or her responsibility, and what he or she is allowed to do. It is often the case that a person agrees to be a Trustee without realizing what it entails. A Trustee must account when asked, must disclose (whether they have to do so affirmatively or passively will be discussed later), and must be careful not to self-deal.

e. Records and accountings upon demand

Upon written demand, a beneficiary is entitled to a written statement of accounting from the Trustee which should cover all transactions from the creation of the trust or the last accounting; whichever is later. Tex. Prop. Code §113.151. A written accounting must show:

1) All trust property that has come to the Trustee's knowledge or into the Trustee's possession and that has not been previously listed or inventoried as property of the trust;

2) A complete account of receipts, disbursements, and other transactions regarding the trust property for the period covered by the account, including their source and nature, with receipts of principal and income shown separately;

3) A listing of all property being administered, with an adequate description of each asset;

4) The cash balance on hand and the name and location of the depository where the balance is kept; and

5) All known liabilities owed by the trust

f. Disclosure to beneficiaries

A Trustee is required to keep "informed" beneficiaries who are entitled to distribution, or who would be entitled to distribution at the trust's termination . Tex. Prop. Code §111.035(c). This is also known as the Trustee's duty to disclose. In Texas, the law is unclear as to whether this is an active duty or a passive duty.

(1). Scope of disclosure not limited to specific request.

The case law available on this subject tends to focus not on "active v. passive," but on concealment. The scope of information required to be provided is not strictly limited to the precise request made, but includes all information in the possession of the Trustee which might reasonably affect the beneficiary's decision with respect to transactions with third parties or enforcement of the beneficiary's rights under the trust. *Montgomery v. Kennedy*, 669 S.W.2d 309 (Tex. 1984); *Shannon v. Frost National Bank of San Antonio*, 533 S.W.2d 389 (Tex.Civ.App.—San Antonio 1975, writ ref'd n.r.e.). The breach of this duty may be either indirect, as where a Trustee advises a beneficiary regarding a course of conduct that might reasonably result in a different decision, *Shannon*, supra, or direct, where a trustee conceals information material to a decision by the beneficiary, as in *Montgomery*, supra. The duty does not extend to information not affecting the rights of the beneficiary. *Huie v. DaShazo*, 922 S.W.2d 920 (Tex. 1996).

In *Shannon*, no specific request for disclosure was made. However, when the beneficiary sought to withdraw her money which was earning a high percentage of interest, she was informed by the Trustee Bank that it would be more prudent to borrow money from the Bank at a lower interest rate and execute a note payable to the Bank. In advising her thus, the court found that the Bank concealed vital information (that she would still be required to pay the Bank interest, when she could have taken her money interest free) from the beneficiary. *Montgomery* centered on a family dispute. In that case, there was a request for disclosure by a beneficiary. Trustee withheld vital information (the potential for a lucrative lease on a piece of property) on the basis that it had not be "specifically" requested. The court found that this violated Trustee's duty to disclose, and as this constituted extrinsic fraud, the settlement both parties agreed to was set aside.

(2). Active v. passive duty in Texas law.

The Uniform Trust Code, provision 813 provides for an affirmative duty to disclose to certain classes of beneficiaries. The Texas legislature sought to remedy the "active v. passive" problem in 2005 by enacting section 113.060 of the Texas Trust Code. This was based on provision 813. The Texas provision was, as follows:

> §113.060. Informing Beneficiaries
>
> The Trustee shall keep the beneficiaries of the trust reasonably informed concerning:
>
> 1) The administration of the trust; and
>
> 2) The material facts necessary for the beneficiaries to protect the beneficiaries' interests.

Unlike the UTC provision, the Texas provision did not limit the class of beneficiaries entitled to disclosure. Another problem was that the Texas provision said the trustee shall keep the beneficiary reasonably informed – but no one knew what "reasonably" meant. Since the provision was so unworkable, it was repealed by the 2007 legislature.

(3). At common law, duty to disclose is passive.

According to Restatement (Second) of Trusts §173, the common law duty was one of passive disclosure. By repealing §113.060, the Texas legislature did not seek to do away with the duty of disclosure, but rather sought a return to the common law duty to keep a beneficiary informed that existed before January 1, 2006 (See the 2007 Legislative Update by Glenn M. Karisch, p. 12 – full text available at www.texasprobate.com/07leg/2007update.pdf). The fact that the legislature repealed a provision which suggested an active duty to disclose indicates that the common-law duty was a passive duty.

(4). Current status of law in Texas.

In Texas, the active v. passive question could go either way. The new uniform laws suggest an active duty to a particular class of beneficiaries. The common law suggests a passive duty to furnish information only upon request. Texas case law indicates both, with the more recent law suggesting a duty that is not strictly active, but that is something more than passive.

However, the Courts do not say the trustee must disclose everything, but rather, that concealment of information that was material and related to information requested is improper.

B. What to do?

1. Educate

Most individuals serving as a fiduciary are trying to do the right thing. Most frequently litigation arises from situations in which the fiduciary fails to understand the distinction between acting in the best interest of another, and acting in an ordinary, common sense manner. Accordingly, when undertaking planning involving individual fiduciaries, it is advisable to provide the fiduciary with guidelines for actions in that capacity. In addition to guidelines, however, it is useful to carefully review the governing document with the fiduciary to assure that they understand their duties and powers under the governing document.

2. Keep records

The fiduciary should understand that recordkeeping is essential, and that he or she must account for property coming into his or her possession and its disposition. As notd above, an attorney-in-fact must account to his or her principal upon request, providing certain information outlined above which is different that that required under the Trust Code, with its distinct specific requirements. Fiduciary should be encouraged to obtain knowledgeable advice so that books and records can be kept in a manner that allows proper accounting. One implication of this is that there can be no cash transactions without retention of proper receipts to substantiate the transaction.

3. Disclose and communication

An attorney-in-fact should keep his or her principal fully informed. A trustee must account to beneficiaries as provided in the trust instrument, or when demanded under the Trust Code provisions, but should account on a more frequent periodic basis. As discussed in conjunction with dispositive planning above early disclosure can prevent disputes, or if a dispute later arises, make an effective defense more likely if no objection is made at the time of disclosure.

V. Ethics

A. Competent and Diligent Representation

Rule 1.01(a) – a lawyer shall not accept or continue employment in a legal matter which the lawyer knows or should know is beyond the lawyer's competence, unless:

> (1) another lawyer who is competent to handle the matter is, with the prior informed consent of the client, associated in the matter; or
>
> (2) the advice or assistance of the lawyer is reasonably required in an emergency and the lawyer limits the advice and assistance to that which is reasonably necessary in the circumstances.

As indicated in the rule, competency may require one to associate with an attorney who is competent in the matter. One may also acquire the necessary skills and information by doing appropriate research. If the matter is of a complex nature and the time it would take the lawyer to acquire the needed information would cause unusual delay or expense, then he should not accept the employment without the informed consent of the client. Tex. Disc. Rules of Prof'l Conduct, R. 1.01, cmt. 4.

It is always good practice for an attorney to have a network of other attorneys available for consultation on matters not wholly familiar to him or her. If the matter is not of the type one does all the time, it is better to assume a lack of knowledge than to give improper advice. Of course, lack of knowledge does not necessarily preclude the acceptance of representation so long as knowledge may be acquired through appropriate research or discussion with colleagues.